

The second quarter will be an improvement on the first

Europe Unit

The eurozone's recovery continues to be slow, although the second quarter ought to be better than the first (0.2%), which came in below expectations (0.4%). At the same time, weak domestic demand, particularly on the periphery, is causing the inflation rate to be somewhat lower than anticipated, and well below 1%. This panorama of slow recovery and persistent low inflation rates led the ECB to adopt a package of measures designed to consolidate the recovery and avoid a de-anchoring of inflation expectations (see ECB Watch). The data from the last six weeks point to growth of 0.3% in 2Q, and remain consistent with our GDP growth forecast of 1.1% in 2014, while inflation for the year as a whole could be around 0.6-0.7%.

Eurozone: the economy could grow by around 0.3% QoQ in 2Q14, with relatively stable inflation below 1%

- **Confidence indicators suggest a slight acceleration in the second quarter ...**

Despite a slight slowdown compared to April (which reported the highest level in nearly three years), the eurozone's PMI index stayed in clearly expansive territory for the eleventh month running, this time driven by services. The European Commission's Economic Sentiment Indicator (ESI) also rose in May and is above its historic average (Figures 3 and 4). The sub-components in the indicators suggest that the improvement in activity will continue in June, although uncertainty is growing, given that new orders in the manufacturing sector and jobs pending have interrupted their growth rate. In short, after the surprise to the downside in 1Q14, both surveys are consistent with GDP growth of around 0.3% in the second quarter, although growth will continue to be fairly uneven between countries, with France below the remaining large countries in the area.

- **... underpinned by the resilience of domestic demand**

The activity data available to date (figures to April) seem to confirm what the confidence indicators suggest. Exports fell slightly again (-0.2% MoM, -0.1% over the average for 1Q14) after shrinking in March, while the increase in foreign orders, lower than in previous months, is a forward indicator of continued weakness in the export sector 2Q14 (Figure 8). Industrial production at the beginning of the second quarter has reported an uptick, at 0.6% above the average for 1Q14, thanks particularly to the positive surprises from the indexes in Italy and, above all, Spain; these values also point to an investment recovery, after the moderation seen in 1Q14. Retail sales surprised to the upside again in April, showing an increase in the quarter so far of 0.6% over 1Q14 (Figure 6). Stability in the job market and improved household confidence, together with still low inflation, suggest that private consumption could continue to grow at moderate rates.

- **The MICA-BBVA model, still with limited information, suggests that recovery will continue at a rate of 0.3% QoQ in the second quarter**

The confidence indicators available to May, particularly the PMIs, bear witness to practically stable growth in activity in 2Q14 (the average of the April-May PMIs comes in at 53.8, 0.7 points above the 1Q14 average, staying in economic growth territory), which is still being led by Germany and with consolidation of a slow recovery in the countries on the periphery.

With this information, our short-term model estimates quarterly GDP growth of 0.3% QoQ in 2Q14, a little more than estimated three months ago. This, together with the slight revision to the upside in 4Q13, is consistent with our growth forecast of 1.1% for the whole of 2014, despite the surprise to the downside in 1Q14 (0.2% instead of the 0.4% we were expecting).

- **We expect inflation to stay low and relatively stable in the next few months. and to rise gradually from the end of the year onwards**

After the volatility in the inflation figures in March and April, because of the Easter calendar effect, the figures for May are another example of the weakness of inflation, confirming that it decreased to 0.5% YoY. The main causes were the deceleration in the price of services and the fall in fresh food prices. Core inflation also fell by 0.3pp to 0.8% YoY.

Our forecasts suggest that inflation will remain relatively stable over the next few months, although a slight moderation (down to 0.4% YoY) cannot be ruled out in the third quarter, due to the price performance of the most volatile components (energy and food), before rising again to annual rates close to 1% by the end of the year. In fact, we expect core inflation to stay practically stable, fluctuating around 0.9% YoY for the rest of the year.

The surprises in the last few months pose clear biases to the downside for our forecast of annual inflation of 0.9% in 2014, since with the most recent data our models are now pointing to inflation coming in at around 0.6-0.7% on average for the year. Furthermore, we are still seeing risks to the downside, particularly deriving from the strength of the euro and the moderation in raw material prices, while the differences between countries will continue, with very low rates on the periphery and moderate rates in central European countries, reflecting the slow recovery of domestic demand.

Germany: more moderate, but solid and balanced, growth

- **Moderation of the contribution of domestic demand, as the temporary effects from the first quarter subside, but partly offset by stronger net exports**

Unlike what we saw in the last quarter of 2013, the most important contribution to growth in 1Q14 was made by domestic demand, thanks to the recovery of both private and public consumption and, above all, to the healthy increase in investment. At the beginning of 2Q14, this trend might start to reverse, given that retail sales in April have fallen, after rising 1.6% QoQ in 1Q14 (Figures 18), despite the improvement in the consumer confidence indicators and because industrial production is not maintaining the robust growth which the construction sector had driven forward at the beginning of the year (1.2% QoQ in 1Q14) (Figures 17).

By contrast, orders from abroad and good export performance in April (1.3% over 1Q14), in conjunction with the stagnation in imports, suggest that net exports could go back to supporting growth in 2Q14 (Figures 19 and 20).

France: doubts as to whether the recovery is settling in

- **Confidence indexes continue to reflect a pessimistic panorama in the second quarter**

As the confidence indicators suggested, both national ones such as the PMIs and those of the Commission, the French economy was stagnant in 1Q14 (after 0.2% QoQ in 4Q13), with the domestic demand components being a drain on growth, particularly private consumption and investment. Data available to April signal a robust increase in retail sales and a slight improvement in industrial production (0.1% over the average for 1Q14), mainly in manufacturing. The confidence indicators to May, though, continue to be fairly pessimistic about the recovery of activity. Exports are still going down (-0.6% over the average for 1Q14), after contracting in the last three quarters, but the heavy drop in imports in April (-2.9% MoM) could imply that the foreign sector will again contribute positively to growth in 2Q14, after siphoning off 0.2pp at the beginning of the year (Figure 31).

Italy: a slow recovery, and dependent on foreign demand

- **Internal demand is still weak, but confidence indicators for 2Q14 offer a rather more positive outlook**

GDP's fall in 1Q14 (-0.1% QoQ) was mainly due to a strong contraction in investment (-1.1% QoQ compared with 0.9% QoQ), which weighed on domestic demand, while net exports again contributed positively to growth (0.2pp). The forward indicators (export orders) suggest that the foreign sector trend could hold firm in the next few months; this has been reflected in the scarcity of activity figures available for 2Q14, which offer a rather more positive panorama, especially in the uptick in industrial production, while the confidence indicators to May continue to rise, particularly household confidence.

Spain: recovery continues to gain ground

- **Internal demand takes over the reins of growth**

The economic recovery is still being supported by the reduction in financial tensions, a more relaxed rate of fiscal consolidation and some of the structural reforms passed in the last two years. For 2Q14, the MICA-BBVA model estimates a variation in the GDP rate of 0.1pp or 0.2pp above that posted in the first quarter of this year (0.4% QoQ in 1Q14).

In terms of the composition of growth in 1Q14, at the beginning of the year there was a slight downwards correction in the total export figures (-0.4% QoQ) and a recovery in domestic demand, particularly the upticks in consumption and private productive investment (0.4% QoQ and 2.5% QoQ in 1Q14). For the second quarter of 2014, the indicators for expectations and expenditure suggest that the downwards correction in 1Q14 has not yet reversed and the indicators linked to non-resident tourism continue to trend towards a moderation in growth. Private domestic demand ought to continue to recover and will probably gain some more traction. All indicators of consumption expenditure and household expectations are showing signs of improvement at the beginning of 2Q14; positive movement of industrial confidence and manufacturing PMIs in the April-May average, as well as the equipment goods IPI in April point to another increase in machinery and equipment investment (see [Spain Economic Watch](#)).

Eurozone

National accounts: 0.2% growth QoQ in 1Q14

Confirming GDP growth of 0.2% QoQ in 1Q14, with domestic demand gaining traction and offsetting moderation in exports. Our MICA-BBVA model forecasts growth of around 0.3% QoQ in 2Q14.

Figure 1
GDP (% QoQ) and contribution by components (pp)*

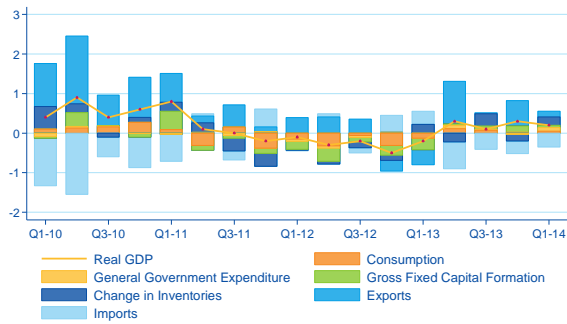
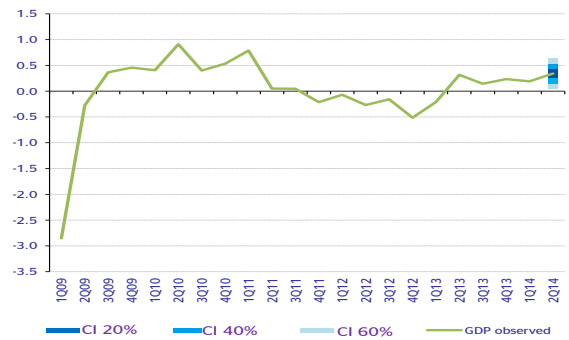


Figure 2
GDP growth (% QoQ) and MICA-BBVA* forecast



Confidence: indicators suggest a slight improvement in growth in 2Q14

The ESI indicator has returned to its upward trend in May in all sectors, while May's PMIs remain in positive terrain, although at a lower rate than in April. The eurozone's recovery is still being led by Germany.

Figure 3
PMIs and GDP growth (% QoQ)*

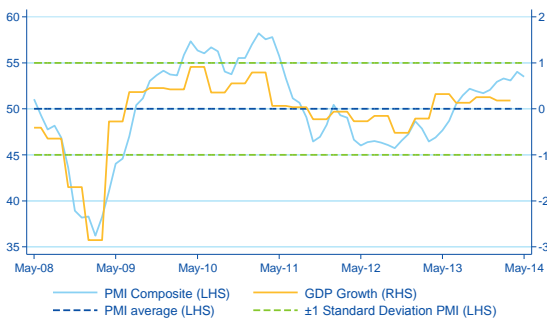
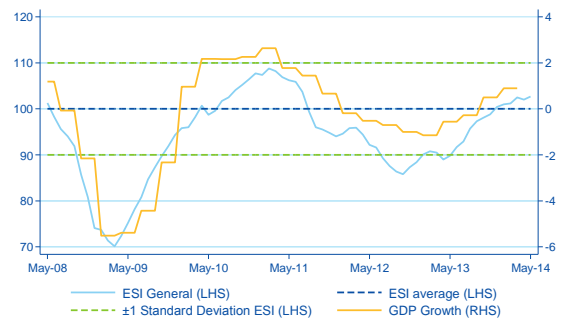


Figure 4
Confidence (ESI) and GDP growth (% YoY) **



Activity: the industrial production data improve, as do retail sales, over 1Q14

After closing 1Q14 with a rise of 0.7% QoQ, retail sales continued to climb in April (0.4% MoM) and pretty much across the board between countries, while industrial production grew by 0.6% to April, above the average for 1Q14, which closed at a modest 0.2% QoQ.

Figure 5
Ind. Production (% YoY), manufacturing new orders & output PMIs*

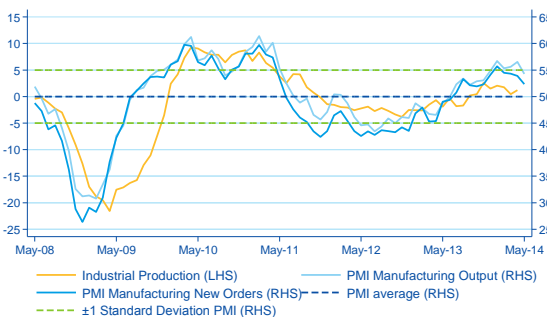
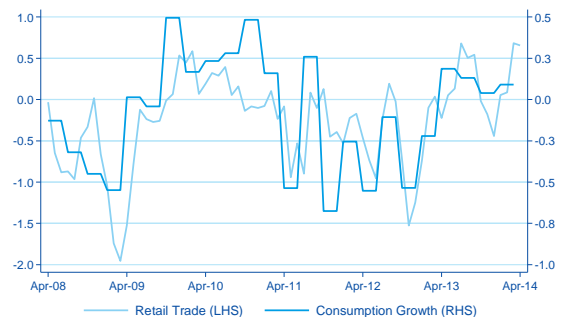


Figure 6
Retail trade (% 3Mo3M) & consumption growth (% QoQ)*



*Source: HAVER and BBVA Research

Foreign sector: weak exports at the start of 2Q14

In April exports dropped slightly, after increasing in 1Q14 (0.3% higher than 4Q13), and imports slowed after growing 1.2% QoQ in the first quarter.

Figure 7
Current account (% del GDP)*

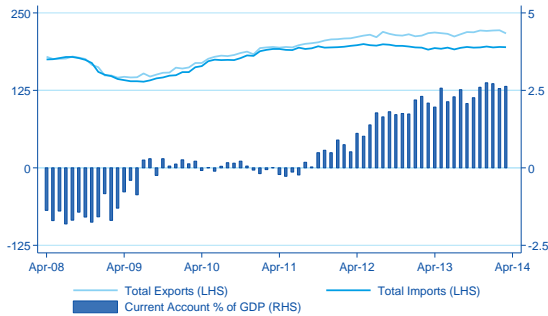
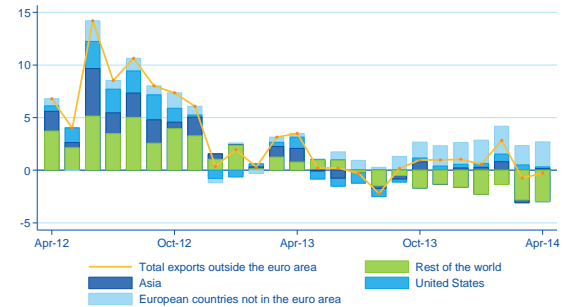


Figure 8
Exports by destination (contribution to % YoY)



Labour market: stable for the last year

Although we expect a moderate recovery to be underway, the unemployment rate is unlikely to fall in the short-term, due to the time lag between activity and employment, as well as the fact that leisure capacity is still at high levels. Even so, wage costs went up in 4Q13.

Figure 9
Unemployment rate (%) and employment expectations*

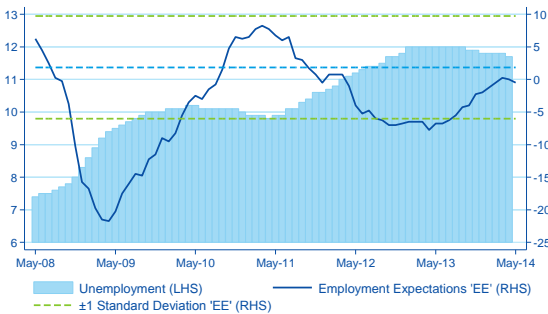
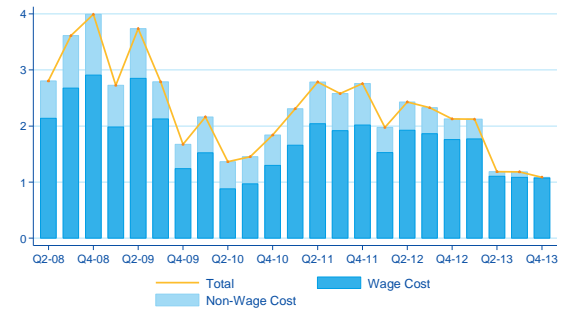


Figure 10
Labour costs in the business sector (% YoY)*



Prices: another surprise to the downside in May, with inflation at 0.5% YoY

Inflation in the eurozone went down by 0.2pp to 0.5% YoY in May, because of the deceleration in prices, both of services and foodstuffs. Core inflation also fell by 0.3pp to 0.8% YoY.

Figure 11
Inflation rate, headline and core (% YoY)*

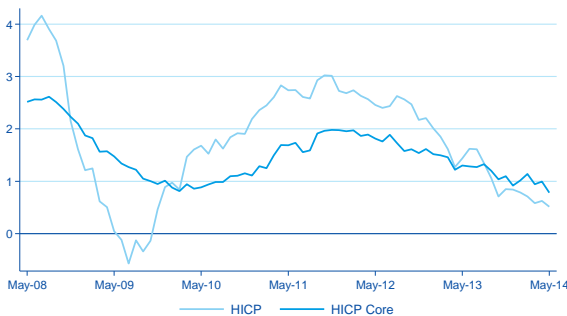
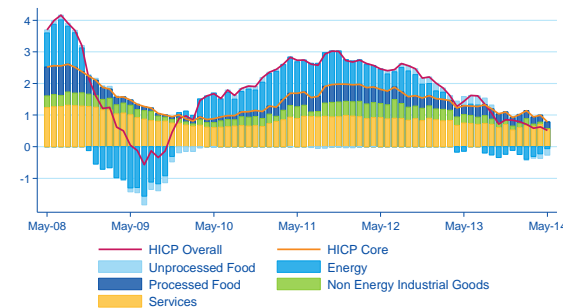


Figure 12
Inflation by components (contribution in %)*



* Sources: HAVER and BBVA Research

Germany

National accounts: domestic demand again contributed positively to growth, thanks mainly to the increase in investment

GDP growth went up in 1Q14 by 0.8% QoQ, thanks to the contribution of investment and, in general, all domestic demand components, while import momentum resulted in negative contribution on the part of net exports.

Figure 13
GDP (% QoQ) and contribution by components (pp)*

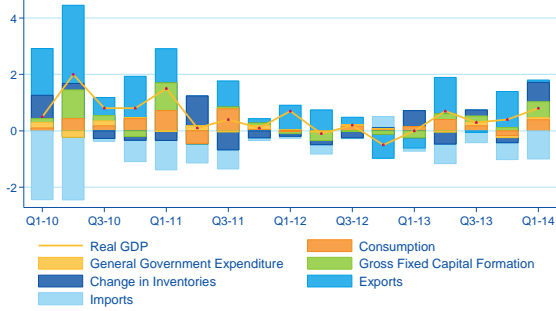
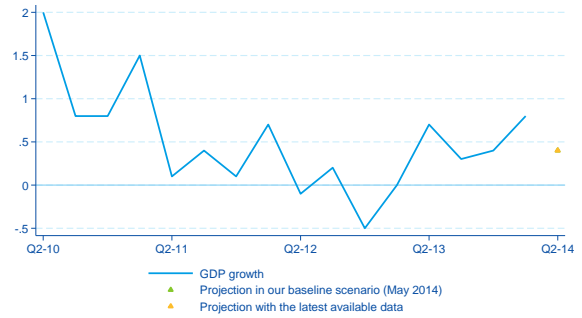


Figure 14
GDP (% QoQ) and forecasts*



Confidence: remaining at high levels in May

The national confidence indicators and PMIs remained at high levels in May, but appear to have reached their peak, after the clear improvements seen since the end of 2012. The services sector continues to be the most dynamic.

Figure 15
PMI and GDP growth (% QoQ)*

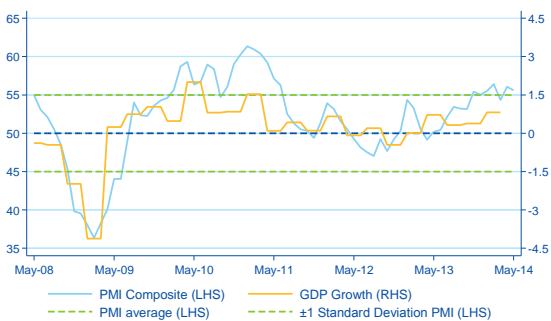
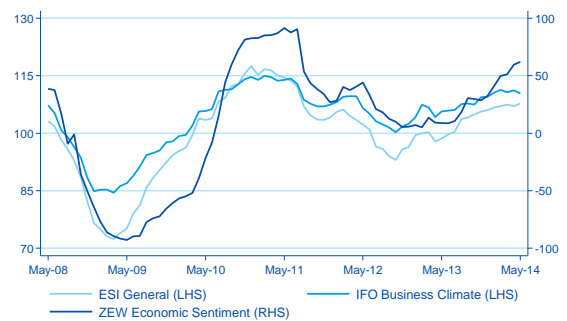


Figure 16
Confidence Indicators (ESI, Ifo and ZEW)*



Activity: industrial production continues to improve, while retail trade moderates in April

Retail sales slowed in April, after rising 1.3% QoQ in 1Q14, and industrial production maintained its positive trend (+0.2% MoM, after +1.2% QoQ in 1Q14), in line with confidence indicators and the continuous rise in industrial orders.

Figure 17
Industrial production (% YoY) and manufacturing PMI*

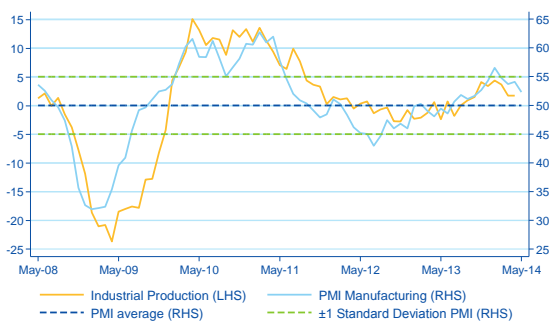
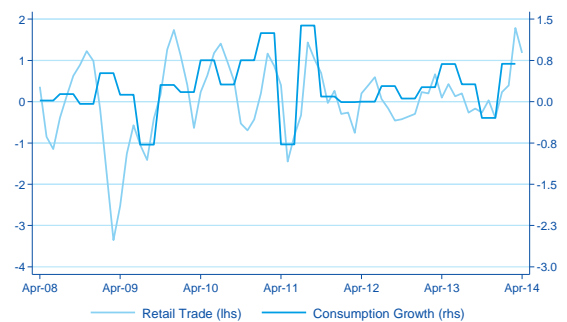


Figure 18
Retail trade (% 3Mo3M) and consumption growth (% QoQ)*



*Sources: HAVER and BBVA Research

Foreign sector: exports rise again in April

After rising slightly in 1Q14 (0.3% QoQ), exports surged in April and did so more than imports. Orders from abroad also increased and augur the trend will remain for the next few months

Figure 19
Current account (% of GDP)*

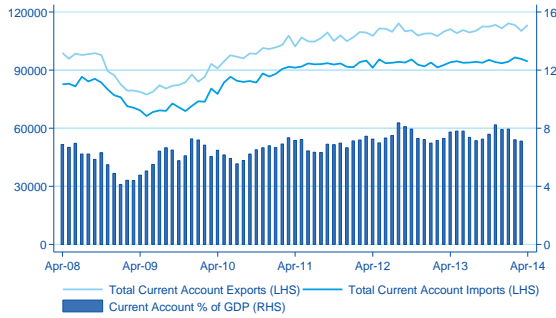
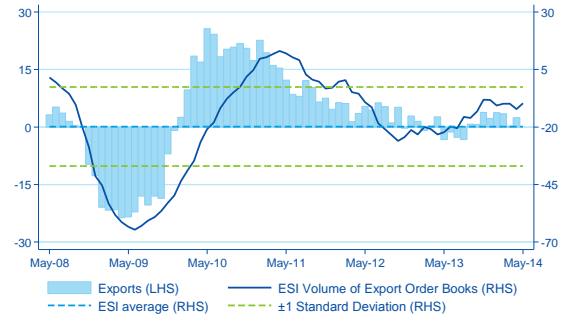


Figure 20
Growth in exports (% YoY) and export order volumes*



Labour market: the unemployment rate is at historic lows

The unemployment rate has stayed at its historic low (5,2%) in April, although this has exerted only marginal upwards pressure on wages, given that labour costs went up 0.4% QoQ in 1Q14 compared to 1.1% QoQ in 4Q13.

Figure 21
Unemployment rate (%) and employment expectations *

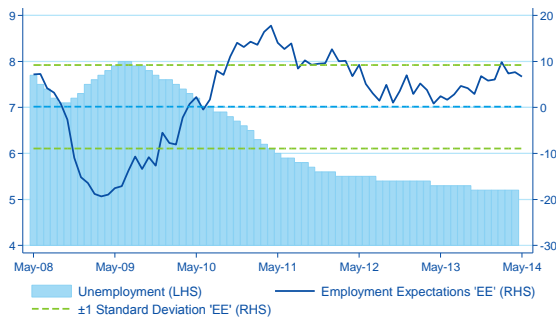
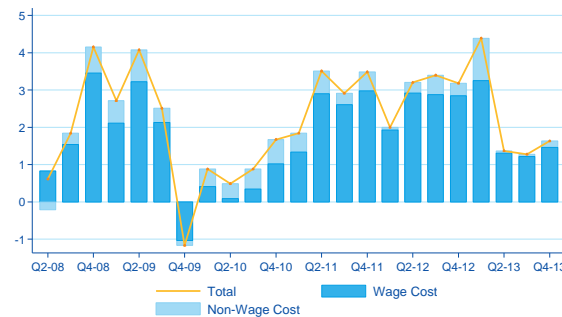


Figure 22
Labour costs in the business sector (% YoY)*



Prices: inflation brakes sharply in May

Harmonised inflation has decelerated 0.5pp to 0.6% YoY in May, principally because of the slowdown in prices of services, due essentially to the disappearance of the Easter calendar effect.

Figure 23
Inflation rate, headline and core (% YoY)*

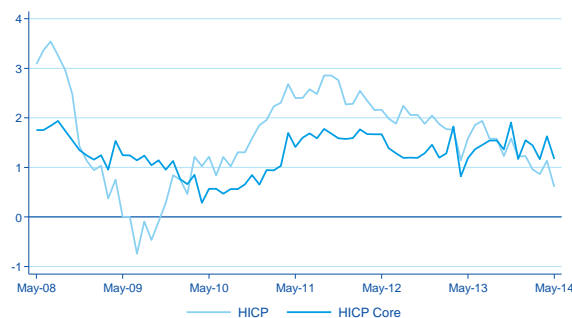
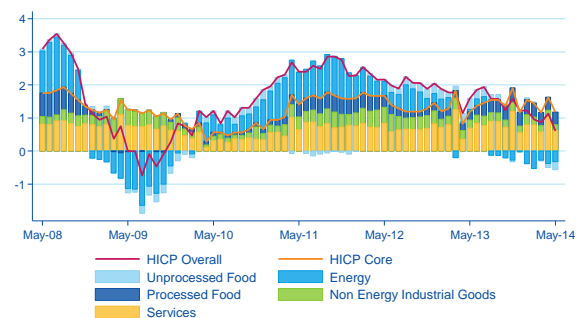


Figure 24
Inflation by components (% contribution)*



* Sources: HAVER and BBVA Research

France

National accounts: no growth in 1Q14

Domestic demand drained growth in 1Q14 (-0.4pp), especially as a result of the fall in private consumption (-0.5% QoQ after 0.2% QoQ) and investment (-0.6% QoQ after -0.1% QoQ). Inventories were the only component to make a positive contribution (0.6pp).

Figure 25
GDP (% QoQ) and contribution by components (pp)*

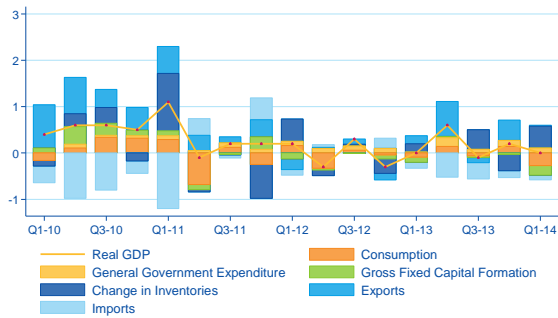
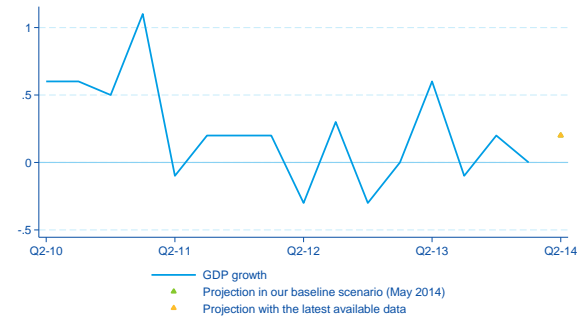


Figure 26
GDP (% QoQ) and forecasts*



Confidence: May indicators raise doubts about the recovery

After remaining in expansive territory in March and April, business confidence in May worsened according to the PMIs and cast doubts as to its recovery. The INSEE, Bank of France and EC confidence indicators are practically flat, but below their historic averages.

Figure 27
PMIs and GDP growth (% QoQ)*

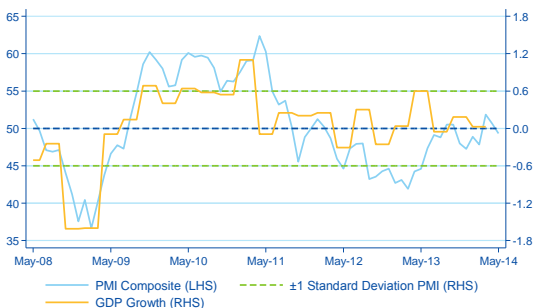
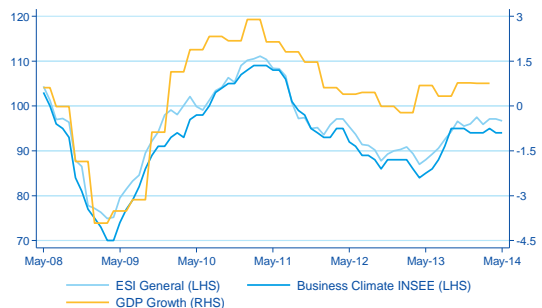


Figure 28
Confidence indicators (ESI and INSEE)*



Activity: industrial production remains weak and retail trade improves

After falling in 1Q14 (-0.3% QoQ), retail sales jumped in April (1.4% MoM); industrial production, however, improved only marginally on the previous quarter, mainly as a result of manufactured goods, which continue their growth trend, begun back in October.

Figure 29
Industrial production (% YoY) and manufacturing PMI*

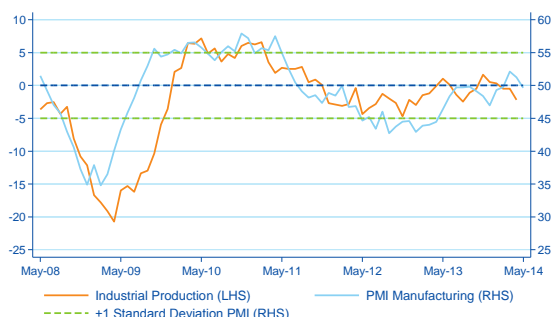
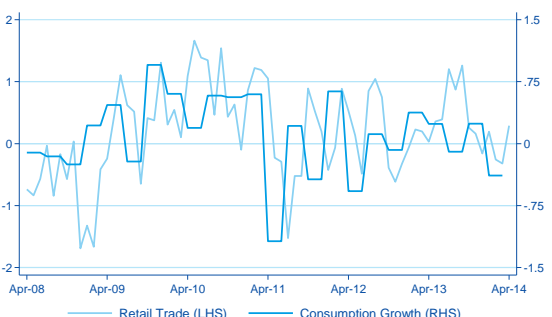


Figure 30
Retail trade (% 3Mo3M) and consumption growth (% QoQ)*



*Sources: HAVER and BBVA Research

Foreign sector: exports continue weak in April

Exports went down in April by 0.7% MoM, after posting their third consecutive quarter of falls in 1Q14, although the brusque fall in imports (-2.9 MoM, after -1. QoQ in 1Q14) ought to show in a positive contribution of net exports.

Figure 31
Current account (% of GDP)*

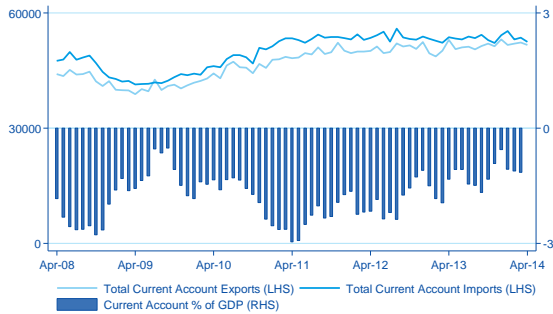
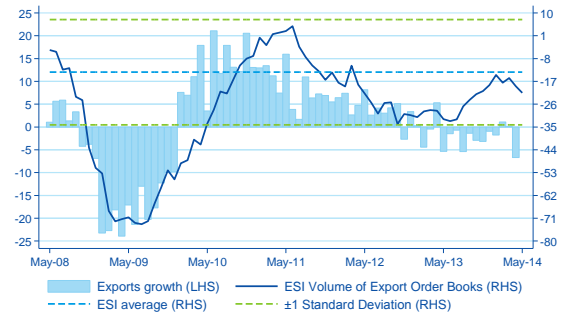


Figure 32
Growth of exports (% YoY) and export order volumes*



Labour market: a degree of stabilisation in the last few months

The unemployment rate stabilised at around 10.3% last year, after having increased by approximately 0.2pp a quarter last year. Labour costs slowed down in 2013 as a result of the fall in non-wage costs, but increased in 1Q14.

Figure 33
Unemployment rate (%) and employment expectations *

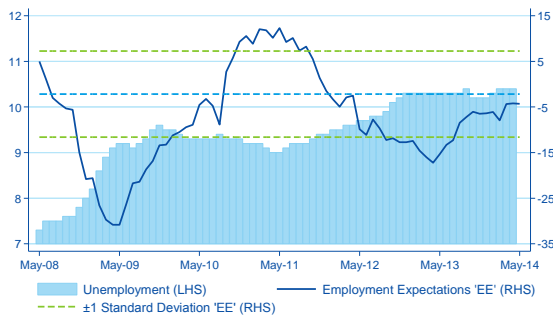
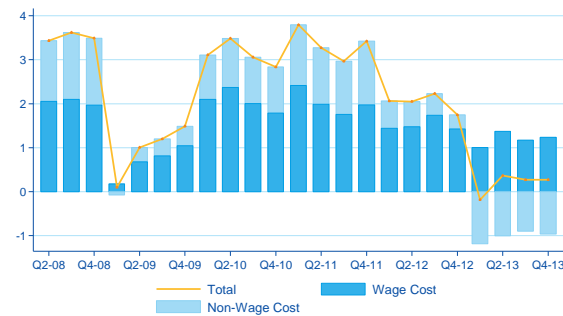


Figure 34
Labour costs in the business sector (% YoY)*



Prices: inflation stable in May

Harmonised inflation remained stable in May at 0.8% YoY, principally because of the rise in energy prices and the slowdown in transport services prices, with the result that core inflation decelerated 0.1pp to 1.1% YoY.

Figure 35
Headline and core inflation rate (% YoY)*

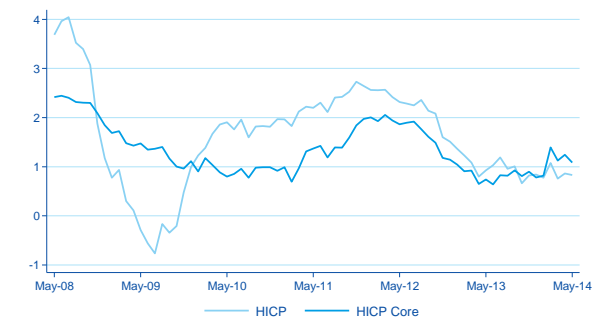
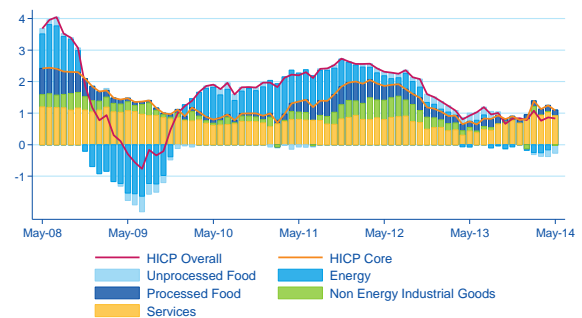


Figure 36
Inflation by components (% contribution)*



* Sources: HAVER and BBVA Research

Italy

National accounts: GDP contracted 0.1% QoQ in 1Q14, burdened by investment

Weak domestic demand again weighed down GDP growth, particularly as a result of the unexpected fall in investment (-1.1% QoQ after 0.9%), while public and private consumption recovered slowly and the foreign sector again contributed positively to growth.

Figure 37
GDP (% QoQ) and contribution by components (pp)*

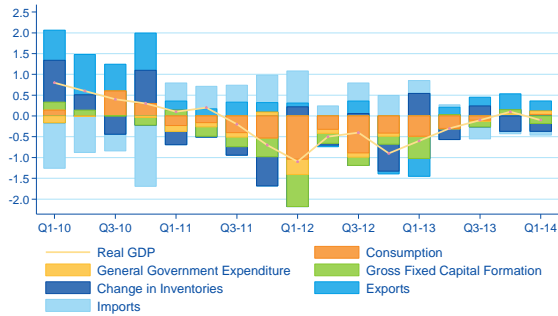
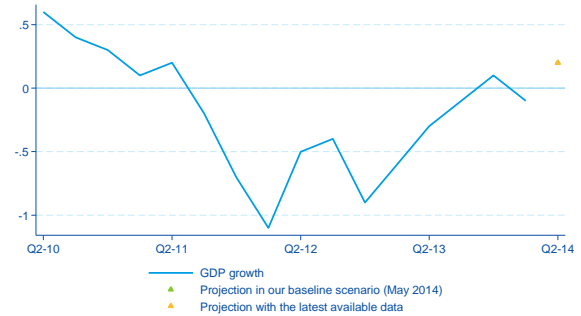


Figure 38
GDP (% QoQ) and forecasts *



Confidence: optimism continues to rise in May

The composite PMI figure stayed in expansive terrain in May for the fifth month in a row, because of better expectations in both sectors; national and EC business confidence indicators have risen again in May.

Figure 39
PMIs and GDP growth (% QoQ)*

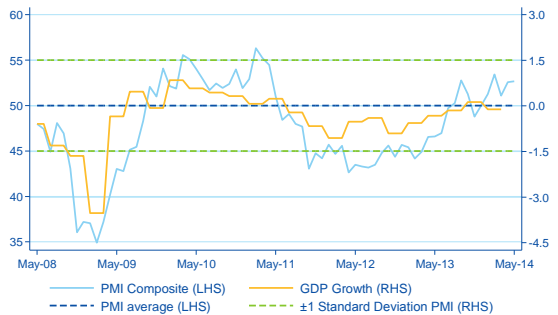
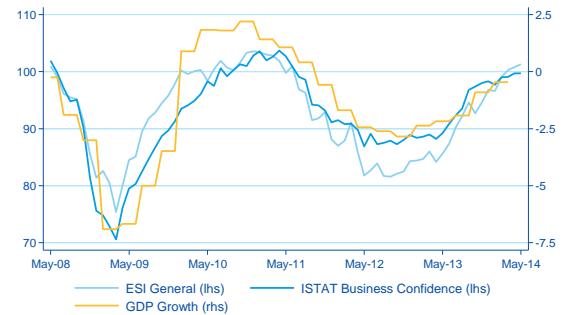


Figure 40
Confidence indicators (ESI and ISTAT)*



Activity: the positive trend in the industrial sector is slowing down and retail trading is weak

Industrial production has increased in April (+0.7% MoM), after falling for the two previous months, confirming the slow recovery of the sector, which began in 4Q13; meanwhile, the eighth consecutive quarter of contraction in the retail trade corroborates the weakness of domestic demand.

Figure 41
Industrial production (% YoY) and manufacturing PMI*

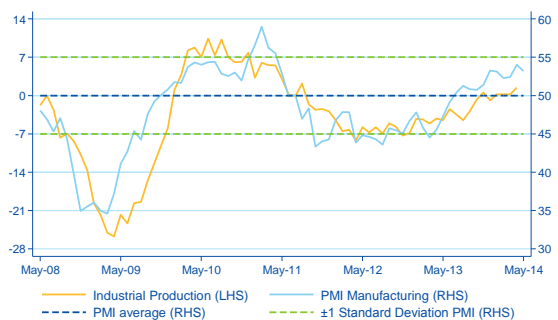
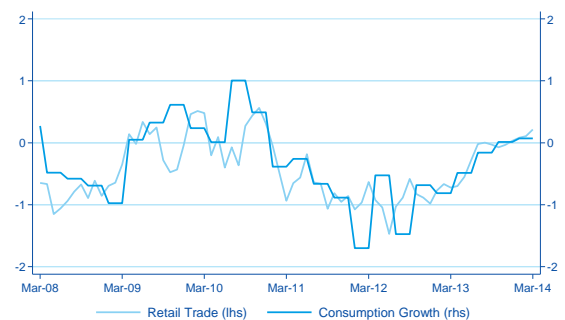


Figure 42
Retail trade (% 3Mo3M) and growth in consumption (% QoQ)*



*Sources: HAVER and BBVA Research

Foreign sector: exports grow slightly in 1Q14

Exports slow down, having increased slightly in 1Q14 (+0.3% QoQ over the average for 4Q13), and imports contract 1.0% QoQ. Net exports continue to be the main growth factor in the short term for Italy.

Figure 43
Current account (% of GDP)*

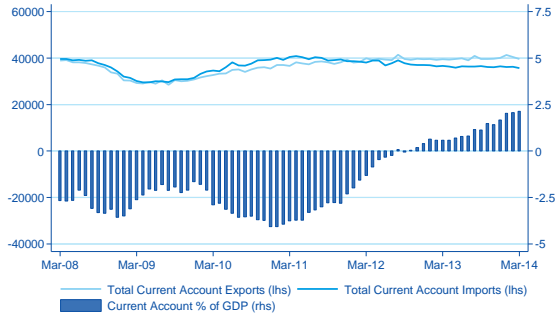
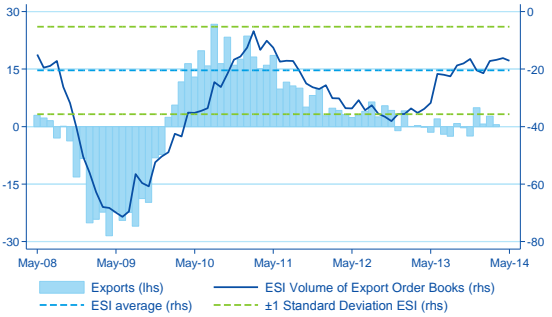


Figure 44
Exports growth (% YoY) and export order volumes*



Labour market: long-term unemployment at highs, with labour costs increasing

The unemployment rates remains very high, nearly the worst figure ever, 1.1pp more than a year ago, and employment outlooks are worsening. Labour costs were still growing strongly in 4Q13.

Figure 45
Unemployment rate (%) and employment expectations *

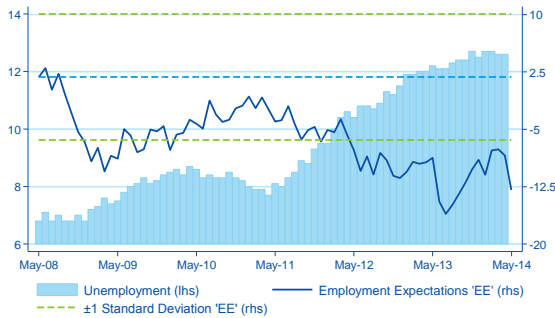
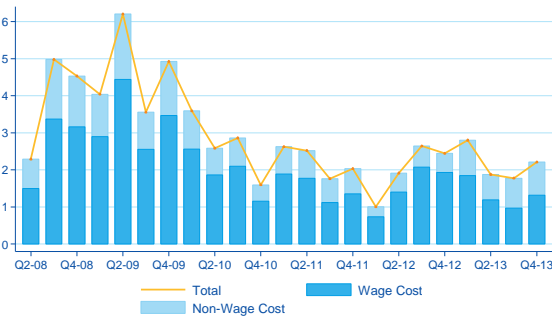


Figure 46
Labour costs in the business sector (% YoY)*



Prices: inflation slows to 0.4% in May

After stabilising at 0.7% YoY in 4Q13, inflation has moderated in 1Q14. In April it accelerated to 0.5% YoY, but has again moderated in May to 0.4% YoY, due to the deceleration of prices in services, particularly transport.

Figure 47
Headline and core inflation rates (% YoY)*

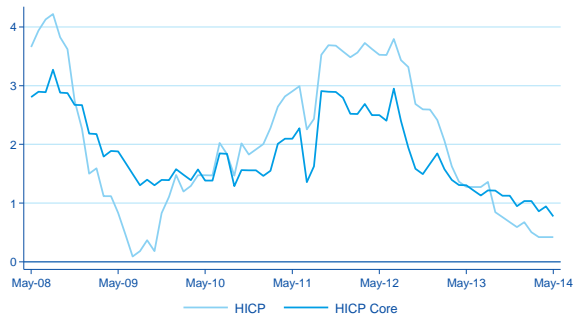
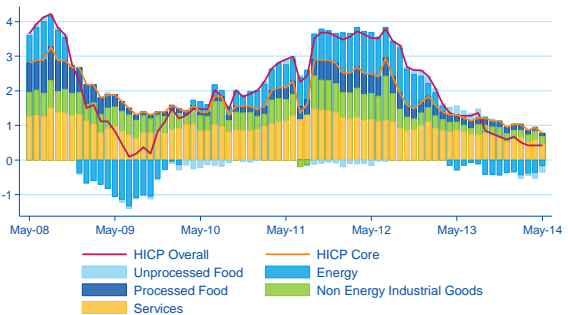


Figure 48
Inflation by components (% contribution)*



* Sources: HAVER and BBVA Research

Spain

National accounts: internal demand takes the reins of growth

The first quarter was characterised by a slight downwards correction in the total export figure (-0.4% QoQ) and by the recovery of domestic demand, where consumption and private productive investment have both jumped (0.4% QoQ and 2.5% QoQ respectively in 1Q14).

Figure 49
GDP (% QoQ) and contribution by components (pp)*

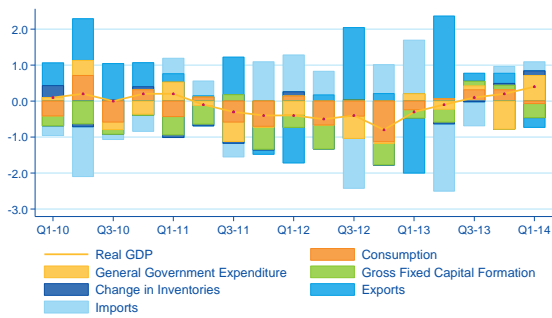
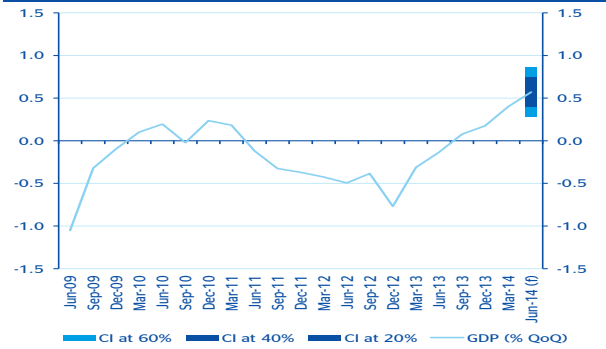


Figure 50
GDP growth (% QoQ) and MICA-BBVA forecasts*



Confidence: outlooks in the second quarter continue to grow

The ESI and PMI indicators have improved consistently so far in 2Q14, with the PMIs well above the growth threshold, especially in services and with consumer confidence clearly trending positively.

Figure 51
PMIs and GDP growth (% QoQ)*

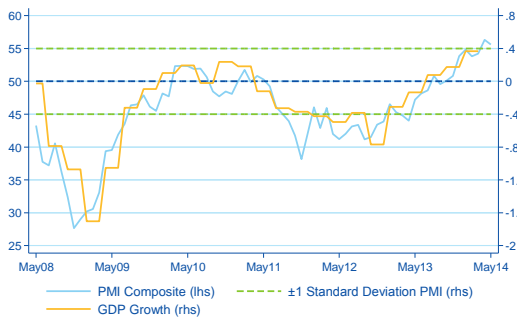
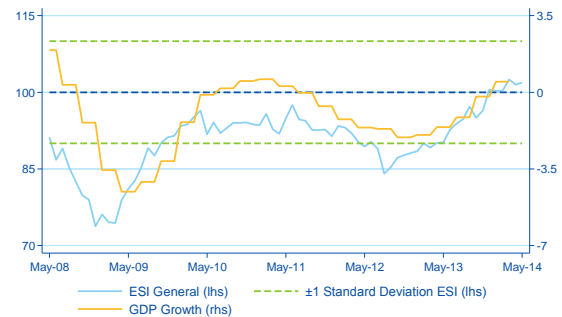


Figure 52
Confidence (ESI) and GDP growth (% YoY) *



Activity: industrial production improvements and retail trade surprises

At the beginning of 2Q14, both the industrial production and the retail trade indexes have gone up more than forecast, with forward and confidence indicators pointing to a consolidation in the upwards trend.

Figure 53
Industrial production (% YoY) and manufacturing PMI *

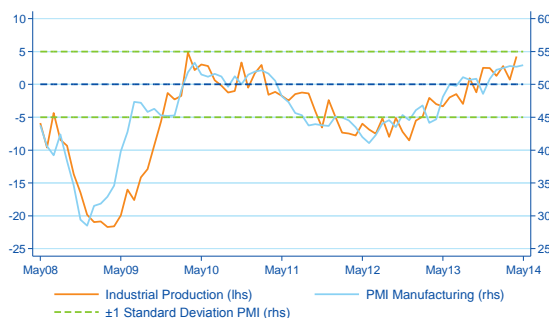
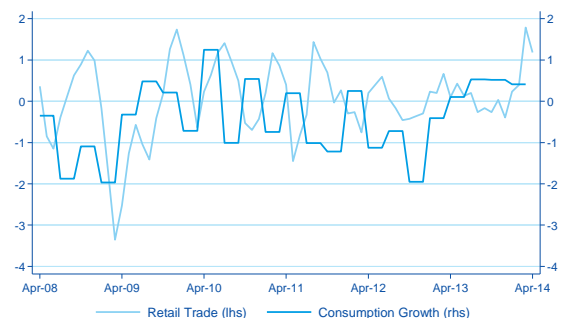


Figure 54
Retail trade (% 3Mo3M) and consumer growth (% QoQ)*



*Sources: HAVER and BBVA Research

Foreign sector: exports lose momentum in 1Q14

The fall of goods exports, not offset by the improvement in exports of service and company expectations (export orders) indicate that the deceleration in exports over the last few months has not yet started to reverse.

Figure 55
Current account (% of GDP)*

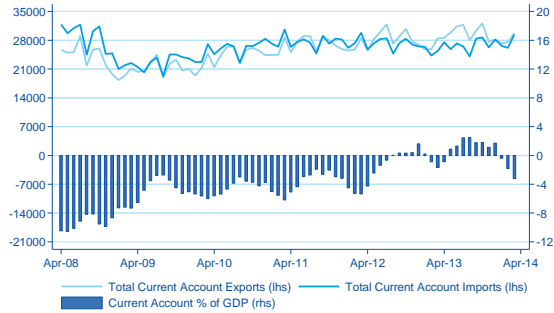
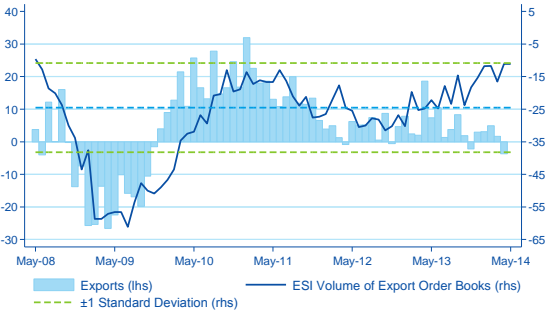


Figure 56
Export growth (% YoY) and export order volumes*



Labour market: more positive signs

Numbers registering new jobs through Social Security went up in May again (nine months of steady job creation), and registered unemployment dropped once more, even after seasonal adjustments, with services accounting for most of the increased occupation.

Figure 57
Unemployment rate (%) and employment outlook *

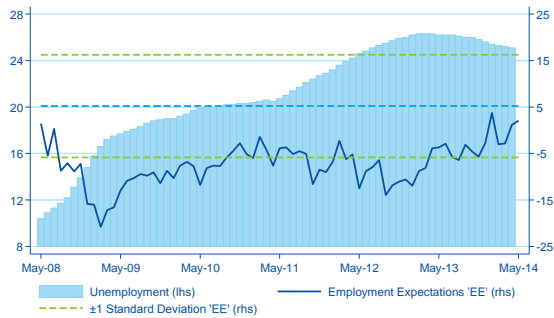
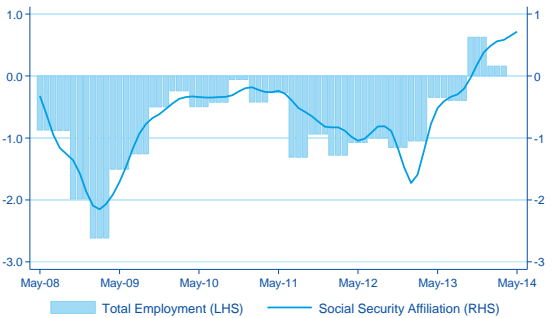


Figure 58
Employment growth: non-affiliates and Social Security (% QoQ)*



Prices: in May, low, but positive, inflation

Measured by using HICP, inflation in May came in at 0.2% YoY, 0.1pp below the figure for April, whereas core inflation may have fallen 0.2pp down to -0.1% YoY.

Figure 59
Inflation rate, headline and core (% YoY)*

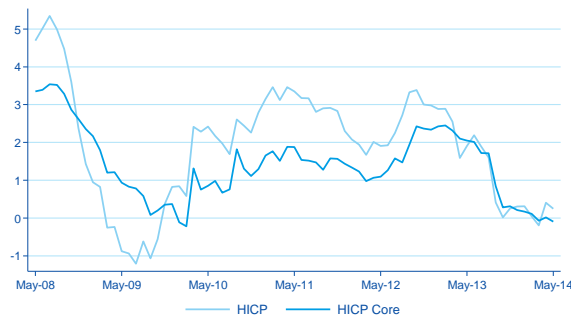
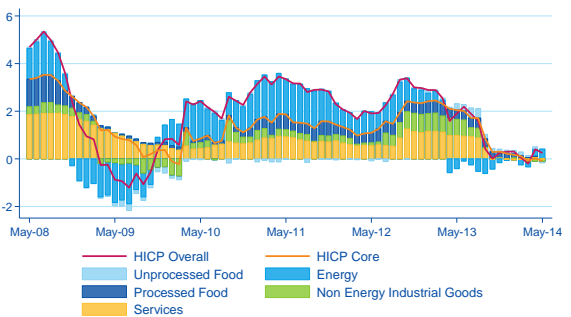


Figure 60
Inflation by components (% contribution)*



* Sources: HAVER and BBVA Research

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